Whiteside & Associates

Memo

From: Terry Whiteside

To: Montana Wheat & Barley Committee

Date: July 18, 2008

Re: Transportation Report

CSX CHALLENGES STB'S FIRST RULING UNDER THREE BENCHMARK RULING – IS THIS MORE DOUBLESPEAK BY THE NATION'S RAILROADS?

Comes now, the mighty CSX Transportation who taking the Surface Transportation Board to court over the agency's recent ruling that the big eastern-U.S. railroad has to cut some freight rates and pay reparations to chemical customer *DuPont*. Both the STB and shippers hailed this first-ever decision under the board's new rules for cases involving small shipments, which ordered CSX to pay DuPont up to $3 million in cash and rate relief for overcharging on six separate shipment lanes. And even though the adjudicated rates were high, there is, at last, a process whereby small shipments call be challenged in front of the STB without resorting to $5+MM Stand Alone Rate case methodology that the utilities use.

But CSX on July 15 asked the U.S. Court of Appeals for the District of Columbia to vacate the decision, saying the STB's action was "clearly erroneous, arbitrary and capricious."

CSX Chairman, President and CEO Michael Ward told analysts July 16 that while CSX had "appealed the STB decision on several grounds," the agency's action showed regulators are doing their job in resolving issues between railroads and customers.

"We think the STB is being responsive to shipper concerns on these small shipper cases," Ward said, "and I think that actually further demonstrates that the current regulatory environment is working."

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That is in line with remarks by executives at other major railroads saying the STB can effectively address shipper complaints about rail pricing and service without tougher oversight laws that are being considered by Congress.

In its submission to the appeals court, however, CSX also said the STB's rate decision was "an abuse of discretion, and not supported by substantial evidence."

Editorial Comment: How can one say the STB's decision was an "abuse of discretion, and not supported by substantial evidence" and they acted "arbitrary and capricious" while at the same time – say in the same press announcement - the STB "showed regulators they are doing their job resolving issues between railroads and customers.?" Does that sound like CLASSIC DOUBLESPEAK to you. Another word – disingenuous also comes to mind. The railroads have once again made a solid case for passage of the Rail Competition Acts in Congress this year - S953 and HR 2125. How can any Congressional representative watch these heavy handed railroad actions and not support the Rail Competition Act?

You could have guessed that would be the outcome. The railroads DO NOT WANT Captive Rail shippers to be able to obtain fair rates – EVER. The railroads do not want any of their rates challenged by its shippers. That was clear in the genesis of the rules which Congress urged the STB to consider developing real rules for future challenges which would be provide a fair platform to rail customers as outlined 28 years ago by Congress in the Stagger Rail Act of 1980. All the way through the process of development of the new rules for small shipments, the railroads tried to throw roadblock after roadblock at the new proposed rules.

- ***They even went so far as stating that if the STB allowed more challenges of small shipments such action would hurt the railroads carriers' ability to invest in new infrastructure!!!***
- ***The most ludicrous argument that the railroads made in the ruling making was that large shippers (such as DuPont) should be precluded from filing 'small rate' challenges – why? Because the railroads argued they are LARGE not small companies even though the proceeding was about SMALL RATE CASES, not small shippers! The STB saw right through this rather sophomoric argument but it shows how far the railroads will try and go to keep shippers from being able to mount effective challenges to unreasonable rates.***

This action by the CSX shows once again the railroad's true colors.

Congress needs to understand the issues here…..the railroads are not interested in fair and equitable treatment of railroad shippers – they want to stifle all challenge, all protections Congress mandated in the Stagger Rail Act of 1980 and keep the captive rail customers exactly that – captive – even at rates higher than 300% of revenue to variable cost. The railroad actions to thwart all attempts to bring

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oversight to protect captive rail shippers, which is called for in the Staggers Rail Act passed by Congress 28 years ago, demonstrates clearly a lack of honesty and integrity by the railroads. The railroads continue to try and woo shippers into believing the Rail Competition bills are somehow re-regulatory – when they are clearly not – speaks to the problem the railroads are starting to see on the Hill. Namely – Congress is not buying the 'sky is falling' scenario any more. See article below on Council of State Governments.

THE MIDWEST CONFERENCE OF THE COUNCIL OF STATE GOVERMENTS PASSED STRONG SUPPORT FOR RAIL COMPETITION LEGISLATION

The Council of State Governments in their Midwest Conference meeting in Rapid City, South Dakota this week passed a series of strong resolutions support Rail Competition legislation in Congress. This was over strong opposition by the railroads. Once again the captive shippers voice was heard over the 'sky is falling' rhetoric of the railroads.

Because of its importance – Whiteside & Associates is summarizing the calls for the resolution and the heart of the resolution.

WHEREAS, Lack of access to competitive rail service is a major concern of rail customers; and

WHEREAS, Since Congress passed the Staggers Rail Act of 1980, more than 40 mergers and consolidations have decreased the number of Class I railroads from over 40 to only seven. Four of these major railroads control more than 90 percent of the industry's revenue and own over 90 percent of the country's track miles. and

WHEREAS, The lack of competition has led to an increase in captive shippers, rising rail rates, and deterioration in service quality. For many products, including grain from some elevators and coal shipped to electric power plants, it is not feasible to ship by any means other than rail, leaving some of the shippers of these products and their consumers "captive" to the single railroad; and

WHEREAS, A major impediment to railroad competition today is the refusal by major railroads to provide a rate to move freight to a competing railroad, since many rail customers can only reach a competing railroad if the railroad serving them will provide a rate to move freight to the competing railroad and the refusal by railroads to provide this rate makes a customer captive to a single rail carrier for the entire length of the freight movement; and

WHEREAS, The Railroad Competition and Service Improvement Act of 2007 requires a major railroad to provide a rate for moving its customers' freight to that competing railroad; and

WHEREAS, A second major barrier to competition in the rail industry is tie-in agreements between short line railroads and major railroads. These agreements prevent the short line from moving freight to or from any railroad other than the major from which it is leasing its track; and

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WHEREAS, The Railroad Competition and Service Improvement Act of 2007, S.953/H.R.2125, directs the removal of these restrictions from existing agreements, upon either its own motion or upon petition by an interested party, unless there are specific over-riding policy reasons to allow the restriction to remain in place; and

WHEREAS, The Department of Justice has indicated to Congress that the failure to provide a rate to a competing railroad and "tie-in" agreements could be a violation of the Sherman Antitrust Act, but for the existing antitrust exemptions; and

WHEREAS, Federal legislation cannot reverse the consolidation that has already occurred or replace the track that has been abandoned and removed. However, federal legislation can address the anticompetitive rulings of the federal rail regulatory agency that have allowed the major railroads to prevent rail customer access to competition; now therefore be it

RESOLVED, that the Midwestern Legislative Conference should support two bills that are pending in Congress to address the lack of competition in the rail industry; the Railroad Antitrust Enforcement Act of 2007, S.772/H.R.1650, which would remove the railroad industry's exemptions from the nation's antitrust laws, and the Railroad Competition and Service Improvement Act of 2007, S.953/H.R.2125, which would reverse the anticompetitive decisions of the Surface Transportation Board, the federal railroad regulatory agency.

The action by the Midwest Conference of the Council of State Legislators follows the National Association of State Departments of Agriculture's strong resolutions earlier this years supporting the same legislation.

STB ISSUES A NOTICE OF PROPOSED RULEMAKING IN THREE BENCHMARK SMALL RATE CASE RULES AKA HERE WE GO AGAIN

A Notice of Proposed Rulemaking (NPR) was issued by the STB in very late June. It deals with what looks like (and is!) an abstruse calculation point in the Small Rate Case Rules, namely, the proper calculation of taxes in the RSAM. This issue came up in the DuPont case. However, the Board was unable to resolve the question in that case. This was because the matter involved the rules that the Board had already adopted in the Small Rate Case proceeding, and the Board could not simply change those rules in the context of an individual proceeding. Thus, the Board released this NPR. The Board is seeking comments by August 2, with reply comments later.

Although this is an abstruse technical issue, it will have a substantial impact on the results of small rate cases. ***If the Board would have adopted CSXT's arguments on this point in the DuPont case, DuPont would not have gotten any relief***. Fortunately for the captive shippers, much of the work in arguing this point was developed in the DuPont case.

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Editorial Comment: It is clear what the CSXT is up to here. If they can get the STB to treat taxes differently they can effectively raise the comparison group R/VC average thereby deny relief to ever higher challenged captive rate levels.

This pattern of trying to tear down every set of rules that is put up that the railroads don't like is a pattern that they, the railroads, have followed for 28 years since the passage of the Staggers Rail Act of 1980. Each time a set of rule-making results in something the railroads don't want, they set about to seek ways to neuter the effect - as in the instant proceeding.

Recall that the railroads are trying, in the new cost of capital rules, to redefine (raise) asset basis that is utilized for calculation of the cost of capital. Under the new cost of capital calculations recently adopted by the STB – virtually all of the nation's railroads are now either at revenue adequacy or approaching it for the first time in history.

And not to be undone by that, the railroads are trying to get the STB to redefine the term 'revenue adequacy' which has been a benchmark for 25 years at the STB to a new term called 'long-term revenue adequacy'. Why? So that the railroads could hide behind that in adjudication of future rate and service cases. Rest assured the railroads will not stop trying to neutralize all regulation of their industry to ensure that no one can interfere with their practice of monopoly marketing.

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